

# The pros and cons of decentralization

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## Three initial caveats<sup>21</sup>

In this discussion, I will focus on a subset of the arguments put forward by Cantillon et al. in their lead piece, not because I believe the other arguments are not important, but simply because tackling all of them would require too much space. Furthermore, my arguments will focus on the economic side of the problem. Finally, even though I concentrate here on the spending side of social security, I would like to mention that any reform of social security should be comprehensive and address not only the spending, but also the revenue side.

Regardless of whether we focus on the revenue or the spending side of social security, a key question to address is: are we talking about the complete decentralization of both the goals and implementation of policy or of its implementation only? To be more explicit, which of the following two options are we thinking about: 1) the federal level sets the goals and rules of the game and the federated entities are put in charge of implementation (this is for example what the Marcourt-Vandenbroucke proposal advocated for the reform of labour market policies; see their lead piece in the second Re-Bel e-book); or 2) full decentralization of the system with the federated entities being in charge of the goals, rules of the game and implementation? If we want Belgium to remain a federation, then the first option should be preferred, as the other option seems more in line with the spirit of a confederation, not a federation. Clearly, the pros and cons of decentralization (both economic and non) depend to a very large extent on whether we are talking about option 1 or 2 above.

Finally, the main issue in any discussion of (social security) reform in Belgium is, unsurprisingly, how to deal with the presence of the region of Brussels (RBC in what follows). We return to some of the problems raised by the presence of RBC in the final part of this discussion.

## Arguments in Favor of Decentralization

Decentralization is typically justified by the following 3 arguments:

1. Information asymmetries;
2. Homogeneity of preferences and willingness to give;
3. Accountability and common-pool/incentive problems.

Information asymmetries, requiring a close link between the rulers and the ruled, are a strong argument in favor of the decentralization of policies that come with conditionalities for potential beneficiaries. Conversely, policies that do not come with such conditionalities (demogrants in the wordings of Cantillon, Pestieau and Schokkaert 2009) are best managed at the federal level, as information about the personal characteristics of potential beneficiaries is not an issue. Thus, in as far as the Flemish FCI is a demogrant –it is a flat, Beveridgean lump-sum transfer of 125 euros to all care-dependent citizens regardless of their age, income and needs in terms of care– the best level at which to manage and implement such a policy seems to be the federal one. Conversely, the efficiency of the implementation and management of the federal TAHB, whose access to and generosity is age-dependent, means- and needs-tested, could probably be enhanced if it were moved down to

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<sup>21</sup> Our discussion also borrows from some of the arguments put forth in Cantillon, Pestieau and Schokkaert (2009) and Schokkaert (2009).

the federated level. On old age care insurance, my favorite solution would be to have the federal level set the goals and conditionalities linked to this policy and then let the federated entities implement this policy, delegating to the latter the collection of the necessary information for means- and needs-testing and management of the scheme.

The existence of differences in preferences is another strong argument in favor of decentralization, provided that by preferences we mean a polity's fundamental and relatively time-invariant preference for a type of system over another. In the Belgian context, I believe we should recognize that the North and the South of the country differ fundamentally along many dimensions that shape one's view of the role of social security. Accordingly, some decentralization is probably needed in order to better tailor the way the different groups of citizens see the role of social security in society. Yet again, the two thorny issues are 1) whether we should decentralize the whole system or its implementation only; and 2) whether we should also assume that the citizens of RBC have their own region-specific views when it comes to social security.

Differences in preferences also imply that, within each group, the higher degree of homogeneity will increase the willingness to give and thus foster the local forces that sustain social security. Yet, the obvious counter-argument is that such a narrowing of circles of solidarity through the decentralization of certain policies will make inter-group solidarity even harder to achieve than today, and could thus threaten not only the social security system, but the whole Belgian federation. I would thus not be shy to point out that this is a dangerous path to take. Furthermore, I would also suggest that such an argument is partially flawed, as it rests on the fortunes and willingness to give of different groups at a specific point in time and, as the history of Belgium and its neighbouring countries suggests, such fortunes can radically change in the space of a few decades.

The issue of accountability and the presence of common-pool/incentive problems are two additional arguments in favor of some decentralization of social security in Belgium. Indeed, both arguments rest around the idea that governments are responsible to their people and that therefore the people should be put in the best possible position to judge the decisions and choices of their policymakers. Sometimes, the rules governing social security imply that one level of government can freeride on another level taking the necessary and costly measures to balance the social security books. Clearly, such incentive problems should be corrected. In general, accountability requires that, for every policy, the level of the authority responsible for the revenue side should be the same as that of the authority controlling the spending side. This is consistent with both a fully centralized and a fully decentralized system. Yet, in the specific Belgian context, decentralization seems to have the edge over centralization as far as accountability is concerned, because, at the federated level, it is easier to identify the decisionmakers who are to be held accountable.

## Arguments against Decentralization

Turning to the arguments against decentralization, the following deserve a comment:

1. Economies of scale, risk-spreading and spill-over effects;
2. Bureaucratic costs, complexity and limits to coordination;
3. Downward social competition and EU restrictions.

Just like a market's efficiency typically grows with the size of the market, so should the efficiency of social security grow with the size of the population of its beneficiaries. Indeed, as soon as there are economies of scale in the production of goods and services, increasing the size of the pool of customers is welfare enhancing. Further, social security programmes being largely insurance ones, maximizing the size of the pool of customers also implies maximizing the opportunities for risk-sharing and pooling. Finally, in the presence of potential spill-over effects between federated entities, centralizing social security seems preferable. Examples of policy areas in which spill-over effects are very important include education and training given that, in a small country as Belgium, a important fraction of the population works in a place that is located in a federated entity that is different from the one where they received their education and/or training (RBC is the obvious but not only example).

Secondly, (especially full, but also partial) decentralization of social security implies, automatically, a multiplication of the bureaucracies in charge of its management. In a country such as Belgium, where the financial room for manoeuvre is so scarce, policies that lead to an increase in the costs of bureaucracy seem

hardly the path to follow. In addition, after the decentralization of the system, firms and other economic actors that are present in more than one federated entity will have to deal with more than one bureaucracy. In a country already singled-out for its barriers to firm and job creation, policies that lead to such a multiplication of red tape and such an increase in the complexity of the system should simply be resisted.

Finally, the presence of restrictions from the EU on what the federated entities can impose on citizens living within their borders and the risk that decentralization may lead to downward social pressure should push policymakers to think carefully about the consequences of their choices before they act. The modifications the Flemish authorities had to adopt concerning the pool of potential beneficiaries of the FCI is a telling example.

## Untouched Issues and Other General Problems

Whereas the paper by Cantillon et al. dealt with many important issues and arguments, I believe the crux of the matter lies very much in what it left out. I thus wish to devote a few words on two of these issues, as I believe a discussion surrounding these should be a top priority. These are:

1. Decentralization to the Regions or the Communities? And what about Brussels?
2. How to make sure the glue that holds a society together is not further dissolved by future reforms?<sup>22</sup>

Belgium, with its linguistic Communities and its economic Regions, poses an extra challenge when it comes to discussions about fiscal and social federalism: should decentralization take place at the level of its Communities, its Regions, or both? Most academic discussions are silent about this issue. Yet, this is probably the toughest Gordian knot to cut. Furthermore, the distinction between Regions and Communities would not be such a major issue if it were not for the presence of RBC and the joint management of some of its policies by the Flemish and the French-speaking Communities. The presence of RBC implies that there are two obvious ways to decentralize social security: 1) decentralize it towards the Regions; 2) decentralize it towards the Communities and let the joint communitarian commission in Brussels (the so-called COCOM/GGC) manage policy in the RBC. The advantage of the latter option is that it allows policymakers to stick to the Constitutional separation of policies Communities and Regions are responsible for (individual-specific policies to the Communities, economic ones to the Regions). An important disadvantage would be that accountability in RBC would be very low: in case of conflict between the two Communities over the best policies for Brussels, how to resolve the conflict, and how to convince the 'losing' side that it should still see positively the financing of policies it did not favor? Finally, if Belgian citizens living in Brussels truly feel *Bruxelois/Brusselaars*, they may resist being dictated policy by policymakers from outside RBC. The former solution in favor of the Regions would go against the Constitution, thus requiring its revision, but would probably have the advantage of its relative simplicity, clarity and accountability, with a well-defined local government in charge of local policies in every Region. Decentralization to the Regions would also score better in terms of preference matching. Yet, to be fully consistent, decentralization to the Regions may require the creation of a fourth, German-speaking Region, at least if German-speaking citizens desire it.

Turning to the second point above, I would like to argue that, in order for the Belgian federation to continue to be viable, any reform should make sure that the erosion of trust that has characterized the North-South relationship in the last few years is at a minimum stopped, if not reversed. Indeed, no reform of the system can ensure its viability as long as the North and South continue to view the game they are playing as a zero-sum one, in which each player's gain is another's loss. One contribution in this area would be to remind all actors involved, politicians and citizens alike, that, as Jacques Drèze (2009) stressed in the first *Re-Bel* e-book, social security programmes are not only transfer programmes but also (and especially?) nationwide welfare enhancing insurance programmes, independently of the level at which they are managed. Obviously, at any point in time, the lucky pay to help the less lucky. Yet, nobody should forget that, tomorrow, they may end up being part of the unlucky group...

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<sup>22</sup> One could argue that this glue, this trust is not an economic issue. Yet, as the wealth of economic and interdisciplinary evidence has shown by now, trust is key for all economic institutions to meet their goals: for example, markets could not work efficiently if market participants did not trust each other and the workings of this institution. I thus feel entitled to including the issue of trust in this discussion.

## Conclusion

Given the pressing problems Belgian social security faces, reforms are clearly needed, and progress thus needs to be achieved. Some decentralization of some policies will have to be decided, if anything to meet the requests of a substantial fraction of the population (the largest part being located in the North, but not only) and to break the policymaking deadlock that has characterized Belgium in recent years.

I would personally favor decentralization of the implementation only of some policies, leaving the setting of the rules of the game at the federal level. Further, accountability, preference homogeneity, transparency and the need to reinforce the Belgian federation make me favor decentralization to the Regions, not the Communities (these reasons could also justify the creation of a fourth, German-speaking Region in the East of the country). Finally, because accountability also dictates that social federalism should go hand in hand with fiscal federalism, the Special Finance Act governing the sharing and division of revenues between the different Belgian entities should be revised too.

## References

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